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Supreme Court of the United States

DEPARTMENT OF SOCIAL SERVICES
OF THE STATE OF CONNECTICUT,

Petitioner,

—v.—

NEAL OSSEN, Trustee,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORAI FOR *AMICI CURIAE* PROFESSORS G. RAY WARNER, ROBERT M. ZINMAN, SUSAN BLOCK-LIEB, JONATHAN C. LIPSON AND TIMOTHY ZICK

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Table of Contents

Table of Authorities ii

INTEREST OF THE *AMICI CURIAE* 1

DISCUSSION OF THE QUESTION PRESENTED 2

SUMMARY OF ARGUMENT 3

ARGUMENT 4

CONCLUSION 8

Table of Authorities

FEDERAL CASES

Alden v. Maine, 527 U.S. 706 (1999).....7

Alexander v. Hillman, 296 U.S. 222 (1935).....6

Citizens Bank of Maryland v. Strumpf,
516 U.S. 16 (1995).....6

Fidelity Financial Services, Inc. v. Fink,
522 U.S. 211 (1998).....1

Gratiot v. U.S., 40 U.S. 336 (1841).....6

Katchen v. Landy, 382 U.S. 323 (1966).....6

Local Loan Co. v. Hunt, 292 U.S. 234 (1934) 7

New York v. Irving Trust Co., 288 U.S. 329 (1933).....5

Studley v. Boylston National Bank of Boston,
229 U.S. 523 (1913).....6

Tennessee Student Assistance Corp. v. Hood,
___ U.S. ___, 124 S. Ct. 1905 (2004).....1, 3, 4, 5

FEDERAL STATUTES

11 U.S.C. § 106(c).....2, 3, 4

INTEREST OF THE *AMICI CURIAE*[1]

Amici Curiae are law professors who teach and write in the area of bankruptcy and constitutional law.[2] Their interest in this

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[1] Pursuant to Rule 37 of the Rules of the Supreme Court of the United States, the *Amici* file this brief with the written consent of all parties, which are appended hereto. No counsel for a party authored this brief in whole or in part. No person or entity including *Amici* or their counsel made a monetary contribution for the preparation or submission of this brief; it has been prepared *pro bono*.

[2] G. Ray Warner is a professor of law and Director of the Bankruptcy LL.M. Program at St. John's University School of Law. He has published numerous articles on bankruptcy and commercial law, and represented the bankruptcy trustee on the brief in *Fidelity Financial Services, Inc. v. Fink*, 522 U.S. 211 (1998), in which the Court ruled, 9-0, for the bankruptcy trustee. He is a founding Director of the American Board of Certification, a former Director of American Bankruptcy Institute, and a Fellow of the American College of Bankruptcy.

Robert M. Zinman is a professor of law at St. John's University School of Law, where he founded the LL.M. in Bankruptcy Program. He has written extensively on bankruptcy law and real estate law topics. He has served as President and Chairman of the Board of American Bankruptcy Institute and is both a Fellow of the American College of Bankruptcy and the American College of Real Estate Lawyers.

Susan Block-Lieb is a professor of law at Fordham Law School. She has written numerous articles on bankruptcy law subjects and is a Fellow of the American College of Bankruptcy.

Jonathan C. Lipson has been an associate professor of law at the University of Baltimore School of Law, and currently is Visiting Associate Professor of Law at Temple University – James E. Beasley School of Law. Professors Block-Lieb and Lipson were among the *amici* who filed a brief in support of the Petition for Writ of Certiorari in *Tennessee v. Hood*, 124 S.Ct. 1905 (2004), and who filed the *amicus* brief on the merits in that case which argued, successfully,

case lies solely in the expeditious, effective and fair administration of bankruptcy cases, and the efficiency and fairness of the bankruptcy system. They file this brief in support of the Petition for Writ of Certiorari, although they support the decision below, because this case poses an issue of vital importance, not only to states, but also to the bankruptcy bench and bar, which regularly deal with claims filed by states against trustees and debtors in bankruptcy cases and offsets that would reduce or eliminate such state-held claims. Over 1.5 million new bankruptcy cases were filed last year, and such filings continue at approximately the same rate this year. Because of the enormous volume of state-held claims in bankruptcy cases, it is extremely important for the Court to resolve the Circuit conflict that has developed on the issue of vital importance presented by this case.

DISCUSSION OF THE QUESTION PRESENTED

Petitioner, the Department of Social Services of the State of Connecticut (the "State"), has presented the issue as "whether, pursuant to 11 U.S.C. § 106(c), a state agency that files a proof of claim against a bankruptcy debtor can be deemed to waive its Eleventh Amendment immunity to a claim of setoff by the debtor when the claim of setoff does not arise out of the same transaction or occurrence as the agency's claim", and additionally, "whether, pursuant to 11 U.S.C. § 106(c), the filing of a proof of claim against a bankruptcy debtor by one state agency waives the Eleventh Amendment immunity of all state agencies".

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that the discharge in bankruptcy of state-held claims is an *in rem* adjudication that does not seek monetary damages or affirmative relief from a state, and thus does not constitute a suit against a state for purposes of the Eleventh Amendment.

Timothy Zick is a professor of law teaching constitutional law at St. John's University School of Law. His scholarly interests include federalism and the First Amendment, and his recent published articles focus on states' rights and state sovereign immunity.

The issues posed in the present case, as to the allowability of a setoff that seeks no monetary or other relief against a state, arise against the backdrop of the Court's decision earlier this year in *Tennessee Student Assistance Corp. v. Hood*, 124 S.Ct. 1905, holding that a bankruptcy court's exercise of its *in rem* jurisdiction to discharge state-held claims does not infringe state sovereignty, and specifically that "the discharge of a debt by a bankruptcy court is ... an *in rem* proceeding". *Id.* at 1910. In light of the theory of *Hood*, the question presented by this case in substance is whether the determination of an offset that would reduce or extinguish a state's claim asserted in its proof of claim, as authorized by 11 U.S.C. § 106(c), is an exercise of the bankruptcy court's *in rem* jurisdiction over the state-held claim and further, whether a state can invoke the jurisdiction of the bankruptcy court by filing a proof of claim and at the same time invoke the Eleventh Amendment to bar an offset that would reduce or eliminate its claim.

SUMMARY OF ARGUMENT

In light of the enormous volume of new bankruptcy cases filed each year, in many of which states file proofs of claim, it is important that the Court resolve the issue presented. We agree with the Petitioner that the question whether a claim asserted by a state in its proof of claim filed in a bankruptcy case can be reduced or eliminated by an offsetting claim of the bankruptcy trustee or debtor, is "an issue of vital importance". (Petition, p.9)

Circuit courts disagree on the issue. In the present case, the Second Circuit ruled against the State. In those jurisdictions in which the lower courts hold that states are immune from such setoffs, distributions to creditors may be delayed until the trustee's or debtor's claim against the state is resolved by a plenary action. In other cases, where distribution is made before the claim against a state is adjudicated in a plenary action, the debtor estate will have to pay the state on its claim and then bring suit in a state court to recover on the claim against the state. At that point, however, the trustee or debtor may be met with the state's

assertion of immunity from suit in its *own* courts. As a consequence, the debtor or trustee could be left without a remedy in any court if an offset is not allowed in the bankruptcy court. These consequences, which interfere with the expeditious administration of bankruptcy cases, can be avoided by sustaining the right to assert setoffs in the bankruptcy courts, as held by the Second Circuit below.

A long line of decisions by this Court supports the Respondent-trustee's position on the merits of the issue presented, culminating in the Court's decision in *Tennessee v. Hood*, 124 S.Ct. 1905 (2004) Under the theory of *Hood*, if a state has not been subjected to "coercive judicial process" and "choose[s] to participate" by filing a proof of claim, the adjudication of an offset would not be "an affront to States' sovereignty." *Id.* at 1911, 1913 & n.5. In adjudicating an offset, a bankruptcy court exercises its *in rem* jurisdiction and does not exercise personal jurisdiction over a state. Such an adjudication thus does not implicate the Eleventh Amendment.

It is vital that the issue be resolved by the Court. Certiorari should thus be granted.

ARGUMENT

There are millions of cases pending in American bankruptcy courts. States frequently file proofs of claim in bankruptcy cases. By filing proofs of claim they seek to participate in distributions of the assets of the debtor estate. Thus, the states voluntarily appear in thousands of bankruptcy cases to collect on their claims, but then, having invoked the jurisdiction of the bankruptcy courts, often plead that they have immunity from offsetting claims that would reduce or eliminate their own affirmative claims against the debtor estate.

Because an offset asserted pursuant to 11 U.S.C. § 106(c) seeks only to reduce or expunge the amount of the state-held claim asserted in its proof of claim, the bankruptcy trustee or debtor

"does not seek monetary damages or any affirmative relief from a State ... ; nor does [the debtor] subject an unwilling State to a coercive judicial process". *Tennessee v. Hood*, 124 S.Ct. at 1911-13 & n.5. Moreover, an offset by a debtor estate "is unlike an adversary proceeding by the bankruptcy trustee seeking to recover property in the hands of the State...", and adjudicating an offset is not "an affront to States' sovereignty." *Tennessee v. Hood*, 124 S.Ct. at 1913-14. In essence, where monetary damages and affirmative relief from a state are not sought and the state is not subjected to coercive judicial process, the bankruptcy court exercises *in rem* bankruptcy jurisdiction resulting from the filing of a proof of claim by a state, and the state accordingly does not have Eleventh Amendment immunity.

A state should not be allowed to escape from the consequences of invoking the jurisdiction of a bankruptcy court by filing a proof of claim. One of the consequences is that the bankruptcy trustee may seek to reduce the amount of the state-held claim or expunge it altogether by an offset of the debtor estate's claim against the claim of the state or any of its agencies. Even Petitioner recognized its amenability to such jurisdiction in its brief to the Court of Appeals for the Second Circuit, in which it stated (pp. 25-26):

> If a state agency elects to submit itself to the jurisdiction of a bankruptcy court by filing a proof of claim, it does so with the knowledge that the debtor may assert certain claims or setoffs against it. An individual state agency can make that judgment after weighing the rights, claims and defenses it has against the debtor and that the debtor has against it.

Indeed, Petitioner could not argue otherwise. Long ago, the Court, in *New York v. Irving Trust Co.*, 288 U.S. 329, 391 (1933), recognized that if a state chooses to participate in a bankruptcy proceeding, it will be subject to its broad powers, stating:

> If a state desires to participate in the assets of a bankrupt, she must submit to appropriate requirements by the controlling power; otherwise, orderly and expeditious proceedings would be impossible and a fundamental purpose of the Bankruptcy Act would be frustrated.

The Court likewise stated in *Alexander v. Hillman*, 296 U.S. 222, 242 (1935), that "by presenting their claims respondents subjected themselves to all the consequences that attach to an appearance," a proposition applied by the Court in defining the broad scope of the bankruptcy courts' jurisdiction in *Katchen v. Landy*, 382 U.S. 323, 335 (1966).

The right to assert a setoff is a "well-established common-law right of debtors ... to offset claims of their own against their creditors," *Gratiot v. U.S.*, 40 U.S. 336 (1841), and the Court has recognized "the absurdity of making A pay B when B owes A," *Studley v. Boylston Nat. Bank of Boston*, 229 U.S. 523, 528 (1913). Much more recently, in *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 18 (1995), the Court again remarked that it is necessary to allow an offset to avoid "the absurdity of making A pay B when B owes A."

In the present case, Petitioner contends that as a creditor it should be allowed to participate in distributions from the bankruptcy estate, and that the bankruptcy trustee's remedy, if any, is to bring a plenary action in a state court against the State to try to recover the money that the State owes to the debtor. There are, however, a number of serious implications and consequences to the "absurdity" of the position taken by Petitioner.

First, if the offset cannot be adjudicated in the bankruptcy court, the debtor's bankruptcy case cannot be closed and distributions to creditors may have to be delayed until the final outcome of the bankruptcy trustee's state court plenary lawsuit against the state based upon the debtor estate's claim against the state. This will impair the effective administration of bankruptcy

cases by increasing their cost and violate the principle that cases should be expeditiously conducted and concluded.

Second, unless an offset is allowed against a state's claim in the bankruptcy case, the bankruptcy trustee, acting on behalf of all creditors of the estate, may be left without any remedy at all to recover from the state on the claim of the debtor estate. As the Court held in *Alden v. Maine*, 527 U.S. 706, 712 (1999), Congress does not have the power under Article I of the United States Constitution "to subject nonconsenting States to private suits for damages in *state* courts." (Italics added.) In short, if a setoff is not allowed, states would be empowered to use the jurisdiction of the bankruptcy courts to collect on their own claims, while at the same time, defeating the availability of the very same courts, and possibly their own courts as well, to bankruptcy trustees and debtors to recover on their claims.

Petitioner's position fails to recognize the inequity of seeking to participate in distributions despite the existence of an offset that would preclude the State from participating in distributions made in the bankruptcy case. Such result would run counter to the Court's recognition that "courts of bankruptcy are essentially courts of equity, and their proceedings inherently proceedings in equity." *Local Loan Co. v. Hunt*, 292 U.S. 234, 240 (1934).

This case thus poses an issue of vital importance to the bankruptcy bench and bar, as well as to states. In light of the disagreement among Circuits, and disparate results reached in bankruptcy courts, this vital issue should be conclusively resolved by the Court. We agree with the Petitioner that the Court should "conclusively resolve this important and unsettled area of federal law [and that] certiorari is warranted." Petition, pp. 9-10.

CONCLUSION

For the foregoing reasons, the Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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